

International Trade Theory

Final exam review questions

(1) HECKSCHER-OHLIN EXTENSION

Assume a diversified Heckscher-Ohlin economy producing 2 goods, X and Y . X is the labor intensive good, and the country exports X . Also assume identical homothetic preferences.

- a. IF the country is SMALL, what is the impact of a growing population and labor force on
 - i. wages?
 - ii. national income?
 - iii. per-capita income?
 - iv. output?
 - v. the export and import intensity of the country (i.e. the share of consumption of Y that is imported, and the share of X production that is exported)?
- b. IF the country is LARGE (i.e. terms of trade can be influenced by the country), what is the impact of a growing population and labor force on
 - i. wages?
 - ii. national income?
 - iii. per-capita income?
 - iv. output?
 - v. the export and import intensity of the country?

(2) TRADE POLICY

- a. Explain the optimal tariff
- b. Explain what the non-cooperative (i.e. Nash equilibrium) setting of tariffs between two large countries means for trade flows.
- c. Based on (b), explain the benefits of cooperative tariff reductions between two large countries.
- d. Explain how the media voter and lobbying models explain observed tariff rates.
- e. Explain the impact import protection has on income distribution.

(3) SCALE ECONOMIES

Assume that we have 2 sectors. Wheat is produced with constant returns to scale, and Manufactures are produced with industry-level increasing returns to scale, while firms price at average cost (because of free entry). The cost functions for W and M are homothetic, and we have labor and capital employed in both sectors.

- a. Explain possible “losses from trade” in this situation
- b. Explain the role of production subsidies in this situation
- c. Discuss the relevance of “national returns to scale” vs. “international returns to scale” for the answers to (a.) and (b.)

(4) OLIGOPOLY

Assume we have two firms producing with identical constant fixed and marginal costs. One in the home and one in the foreign country

- a. Explain why we will have a home market effect
- b. Explain how market share can be influenced by tariffs or subsidies
- c. Why might a government want to use import protection, given (b.)